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MAJOR TRENDS IN RUSSIAN RETAIL MARKET

by Andrey Gidasov

Expert estimates put Russia's total retail market size at \$100-120 billion annually, with Moscow accounting for 25 percent of the total. During the past year alone retail turnover throughout the nation grew by 11.5 percent. This strong growth in retail markets, augmented by marginal successes in domestic retail chains, has made Russia a more attractive market for major foreign retail chains.

Following the success in Russia of Sweden's IKEA, such chains as Germany's METRO AG, Turkey's Migros Turks, and France's Auchan are now poised for broader expansion, while additional foreign retailers, such as Germany's AVA and Cyprus-based Wakelin Promotion, are just entering the Russian market. Faced with bustling foreign competition, Russia's leading retailers have reacted by developing a comprehensive system of alliances and establishing joint policy, expanding further into Russia's regions, and investing in the modernization of their distribution and storage networks.

Core problems faced by foreign retailers in Russia include high country risk, soaring bureaucracy, weak purchasing power, and poor development of local production and market infrastructure. Nonetheless, market potential is quite large, and major foreign and domestic retail chains are continuing to pour sizeable investments into the construction

of shopping areas, malls, and wholesale trading centers. U.S. companies interested in the Russian retail market should consider pressing their competitive advantages, while the market is still in its developmental stage.

Foreign Retailers Arrive and Expand

Last year, several transnational retail chains identified Russia as a lucrative retail market. Huge market size and potential, the gradual recovery of the domestic consumer, booming growth in the construction sectors of Moscow and St. Petersburg, and sizeable profits realized by Russian retail chains are bringing major foreign retailers to Russia.

IKEA started its business in Russia in 2000, opening a wildly successful store in the Moscow suburbs. Reportedly, the company has invested more than \$150 million in its local operations. IKEA now has 50 suppliers in Russia and, in the next 5-7 years, the company would like to increase the number to 200-250. IKEA has three purchasing offices in Russia—in Moscow, St. Petersburg, and Novosibirsk. IKEA is reportedly planning to invest up to \$40 million in the development of its furniture and office equipment sales network in the Nizhny Novgorod region. In addition, the company plans to set up a training center for Russian enterprise management and work to boost domestic furniture procurement.

The general director of Turkey's Ramenka reportedly identified Russia as a priority market for Migros Turk (Ramstore). The newest Ramstore in Russia will become the largest of Ramenka's 700 supermarkets across the world. This year, Ramenka plans to invest \$110 million in the construction of two trade centers and a distribution center in Moscow Oblast, and plans are progressing for a new supermarket in St. Petersburg. In autumn, Ramenka plans to open its first supermarket in Krasnoyarsk, eastern Siberia. Negotiations are also under way with Nizhny Novgorod, Kazan, and Vladivostok authorities to open more supermarkets.

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VENTURE FAIR TO LINK BUSINESS AND CAPITAL

Third Russian Venture Fair

October 17–18, 2002

Manezh Exhibition Hall, St. Petersburg, Russia

The **Third Russian Venture Fair** will bring together 60 promising Russian high-tech companies, selected from over 200 applications from 20 regions of Russia, with interested investors that control some \$1.5 billion.

The purpose of the Fair is to provide an opportunity for technology entrepreneurs from all over the Russian Federation to meet domestic and international investors. Investors may view companies' products and services on the exhibit floor, and schedule private meetings with entrepreneurs to discuss investment opportunities.

The distinctive feature of this year's Fair is the opening of an additional area to represent companies that have gone through

a complete cycle of venture investment and are getting ready for an investor's exit by direct sale of their shares to a strategic partner or through the stock exchange (the Fair's partner in this work is the St. Petersburg Stock Exchange).

Russian Venture Fair is the main and most prestigious event of the Russian private equity and venture industry.

For more information, contact

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OBTAINING, PERFECTING, AND ENFORCING SECURITY INTERESTS OVER COLLATERAL IN EURASIA

by Laura M. Brank and Philip W. Webb

Foreign lenders are often reluctant to lend money to borrowers located in Russia and other Eurasian countries because they believe it is impossible to receive adequate protection to secure repayment. However, the legal regimes in most Eurasian countries have been evolving such that each of these countries now permits creditors to obtain security interests over a wide range of collateral and to receive other types of protections to secure their rights. Moreover, many countries have now established registration bodies where lenders can verify whether the secured property has already been pledged, something that was mostly impossible just a few years ago. While actual enforcement of lenders' rights has not caught up with legal statutes, there is growing indication that enforcement problems are also being addressed in a number of Eurasian countries. It is important for U.S. companies and banks to be cognizant of issues related to creating, perfecting, and enforcing security interests in the various countries of Eurasia.

What Is a Security Interest?

Generally, most assets or rights may be subject to a security interest, including inventory, movable property, buildings and other immovable property, an enterprise as a going concern and receivables or other contractual rights.

In many Eurasia jurisdictions, however, certain assets may not be pledged. For instance, in Russia and other Eurasian countries, a pledge of money is not enforceable. Instead, a lender usually obtains a pledge over the rights to the bank account. Other assets or rights over which lenders may not obtain security include: non-transferable assets and rights (nuclear material, drugs, etc.); claims "closely related to the identity of the holder" (alimony, claims for personal damages, etc.); rights over underground natural resources and, in certain countries, land rights and licenses issued by a state authority.

Obtaining and Perfecting a Security Interest

Creditors must have a written pledge agreement that specifically and accurately describes the pledged property, the obligations secured, and the mechanism for implementation of the pledge in order to create a valid security interest.

Most Eurasian countries require that pledges over certain property be notarized and/or registered. Specific requirements vary considerably, so only a few generalizations may be made. If the rights to the underlying property must be registered, then the pledge of such property should also be registered. For instance, in Russia, non-registration of a mortgage agreement renders the mortgage void as a matter of law. Even if registration of a pledge agreement is not required, in order to create a valid security interest, notarization/registration is always advisable.

Notification and/or consent of third parties may also be required to create a binding security interest. For instance, third-party consents are generally required to pledge bank accounts, trade receivables, shares or interests in a closed joint stock company or a limited liability company.

Level of Protection Provided to Secured Creditors

Because existing security interests generally have priority over subsequent pledges, the moment a security interest arises may determine its priority. A security interest normally arises when the pledge agreement is entered into, but, if the pledge must be registered, the security interest arises only upon registration of the pledge agreement.

In bankruptcy, the priority regime operates slightly differently. Secured creditors still have priority over non-secured creditors, but they will not always be paid first. For example, in Russia, debts such as payments for personal injuries and employee claims for overdue salary have priority over secured creditors' claims. Furthermore, most Eurasia bankruptcy laws permit the setting aside of any security deemed a preference granted during the preference period (six months to one year, depending upon the jurisdiction).

Enforcement of Pledge Rights/Foreclosure

The most common method of enforcing a secured creditor's rights is foreclosure by application to the courts for public sale of the collateral (Ukraine and Turkmenistan allow private sales). Some Eurasia countries permit foreclosure through a marshal of law, without going to court. However, foreclosure on real property almost always requires a writ of the court.

It is also possible in certain countries to enter into a separate notarized agreement after the circumstances for levying execution have arisen. In practice, however, the debtor/pledgor will likely challenge the security interest, and thus judicial enforcement is almost always necessary.

Other Protections for Lenders

Creditors may also obtain other types of protection to mitigate risk in these countries. For instance, a creditor may receive rights of set off or an assignment over contractual rights. A lender may also request that the loan be guaranteed by a creditworthy sponsor.

In Russia, Uzbekistan, Tajikistan, Kyrgyzstan, and Azerbaijan, only banks and other financial institutions may issue legally binding guarantees, but any party can issue a surety. A guarantee/surety does not require the consent or permission of, or registration with, the central bank, with two exceptions.

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Real estate developer Wakelin Promotion has invested \$35 million in Zolotoi Vavilon, a new retail center in Moscow. The 39,000-square-meter mall has retail stores, restaurants, a movie theater, and other facilities. The anchor tenants will be a Perekryostok hypermarket and a Luxor cinema. The company plans to build similar retail centers in other areas of Moscow.

Luxembourg's Dorinda Holding is reportedly planning to invest \$70 million to establish the OKAY hypermarket chain in St. Petersburg. Over the next 7 years, the company plans to build seven hypermarkets. The first store opened in May 2002, and another one will open by the end of the year. The first 10,000 sq.m. hypermarket holds 18,000 types of goods, with food products accounting for 60 percent of goods, household appliances and other household items making up 30 percent, and clothes and shoes the remaining 10 percent.

U.S. Company Prospects

The examples above represent only a fraction of current projects to develop retail markets in Russia. The Russian retail market is expected to continue its rapid development for another 6-8 years. During this time both new Russian and foreign retail chains will appear on the market. The existing networks will expand and eventually merge. Russian retailers will face significant competition from foreign retail giants, and only the strongest players will remain on the market. The major retail "battle" will be played out in the Russia's regions.

Based on advantageous real estate pricing and consumer spending levels, Moscow Oblast remains one of the strongest potential areas for retail chain developments. U.S. companies should consider the following opportunities:

- establishing relationships with local retailers in order to supply consumer goods to supermarkets
- strong demand for food processing and packaging equipment
- new stores' needs for retail equipment and fixtures (refrigerators, displays, cash machines, etc.)
- construction and real estate development.

However, U.S. companies should be aware of a number of difficulties in entering the Russian retail market including a lack of western-style logistical management and infrastructure development, a deficit in qualified personnel, circuitous customs procedures and high customs tariffs, and prohibitive land lease policies. Finally, Russian regions feature a completely different business mentality than Moscow, and it is necessary to carefully craft regional policy based on local criteria.

*For a complete report on trends in the Russian retail market, visit **BISNIS Online** at www.bisnis.doc.gov/consumer.htm.*

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*Marina Parshukova, commercial specialist for the **U.S. Commercial Service** in Moscow, contributed to this article.*

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UKRAINIAN INFORMATION AND COMMUNICATIONS TECHNOLOGIES: A DYNAMIC MARKET

by Jeffrey Kamins

Ukraine is emerging as a market to watch for information and communications technologies (ICT). It has significant potential for information technologies both in terms of production capability and as an end-user market. As the penetration rate of communications technologies is low, the potential for growth is big—for instance, Internet penetration is only 3 percent, mobile telephony penetration is 4.7 percent, and fixed-telephone line penetration is 21 percent. Although foreign investment has been low partially due to political instability, the communications sector commands the greatest share of foreign investment. In fact, the ICT sector is unique compared to other sectors in Ukraine because of the relative ease of finding a reliable partner, transparency, tax incentives, plenitude of savvy, technologically qualified managers, and a comparative advantage dating back to Soviet times when Ukraine played a critical role in many of the country's advanced technologies.

Communications Technology Consumers

On the consumption side, the Ukrainian market is not one to be overlooked. It is a 50 million-person market, with only a 20.7 percent rate of teledensity. Today, fixed line telephony is being bypassed for digital solutions provided through DSL, wireless, cable, and satellite networks. **Hughes Network Systems** has been revolutionary in Ukraine by offering satellite-based, two-way and one-way direct Internet and cable services. IP telephony has also undercut the Ukrainian monopoly of Ukrtelecom (80 percent of the market), by offering as much as 80 percent savings over the fixed-line rates.

In terms of mobile telephony, the market has grown 170 to 190 percent in the past 3 years, and it is expected to reach nearly 3 million subscribers by the end of 2002. However, this market is dominated by Ukrainian Mobile Communications (UMC), with 46 percent market share, and KyivStar (49 percent). Foreign investment in these two players has been significant and is the basis of their dynamism. Since 1997, the competition expanded to five operators in Ukraine, which collectively offer NMTi, GSM 900, GSM 1800, and D-AMPS standards. Motorola, Ericsson, **Qualcomm**, Siemens, and Hughes supply the switching equipment. Mobile penetration still has room for growth as well at only 5 percent compared with the Czech Republic at 52 percent.

In addition to satellite solutions, wireless provides a solution to Ukraine's regions that would normally have to connect to the Internet through Kyiv's international gateways, significantly reducing connectivity to 28K bits per second. As of 1997, two companies were awarded with fixed-wireless licenses in Ukraine: Telesystems of Ukraine and **Ukrainian Wave**. Both Hughes and **Lucent Technologies** have been successful as vendors of equipment to TDMA and CDMA providers. Moreover,

there will be additional room for growth once the pivotal privatization of Ukrtelecom occurs.

Internet usage has been growing steadily since 1998, with a market of about 500,000 active users and some 260 internet service providers, which are beginning to consolidate. The penetration rate of 3 percent is still quite low compared with Central Europe at 12 to 15 percent. DSL has emerged on the market and is offered by Ukrtelecom, Lucky Net, and **Golden Telecom**.

As a result of growth in the communications sector, demand has flourished for supporting hardware and software. Intel considers Ukraine to be one of the fastest growing markets in the world for its products. **Microsoft**, despite opportunity costs due to software piracy, realized 100 percent sales growth in Ukraine from October 2001 to June 2002. Desktop sales accounted for 250,000 to 300,000 units in 2001, notebooks 12,000 units, and servers 10,000 units. This was supported by unprecedented retail sales growth of 8 percent for 2001 and a surge in small businesses start-ups needing office equipment.

E-commerce, particularly B2B and B2C, is expected to grow and develop in the next few years. Rolling out e-commerce has been slow for a number of reasons: (1) lack of Internet security, (2) low credit card use, (3) poor Internet connectivity speed, (4) lack of legislation, and (5) low Internet familiarity and usage. Yet e-commerce retail trade for 2001 reached \$1 million. E-commerce is strongly anticipated to grow as a solution enabling supply chain management and just-in-time delivery to provide a remedy for the frequent logistical delays in Ukraine.

Information Technologies Producers

As with many of Ukraine's industries, a lack of capital has hindered the development of the latest information technologies, but there is an abundance of intellectual capital. A number of innovative software development enterprises were formed in the last 10 years, and recently there has been a consolidation of the talent into competitive companies. These companies have begun to service clients globally. Although some earnings are being allocated toward capital investment, many of these companies do not have capitalization to expand operations. Therefore, the prospect for venture capital and foreign joint ventures is highly promising as many of Ukraine's IT companies reach the stage of attractiveness to foreign investors.

The Ukrainian Association of Software Developers estimates there were 1,400 software development companies in Ukraine as of June 2002. The future IT labor market continues to show signs of solid growth, according figures on graduates

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In Azerbaijan, credit organizations must obtain a license from the National Bank to issue a guarantee, and in Kazakhstan, bank guarantees must be registered with the National Bank. In certain countries (e.g., Belarus) a creditor must seek payment from the debtor before proceeding against the surety; other countries (e.g., Russia) allow joint and several liability.

Obtaining security interests over property in the various countries of Eurasia is possible. However, it is important that the local rules are strictly followed in order to ensure that valid security interests over the collateral are established. Describing the pledged property in detail is paramount, and the enforcement mechanism should be consistent with local procedures. It is also important to ensure that the pledgor obtains proper corporate approvals with respect to the pledge and the underlying transaction. Finally, it is essential that any pledge agreement be drafted in a form suitable for enforcement in the jurisdiction where the pledged asset is located.

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*For more information on legal issues related to Eurasian countries, visit **BISNIS Online** at www.bisnis.doc.gov/legal.htm.*

UKRAINE ICT CONTACTS

U.S.-Ukraine Digital Alliance (USUDA)

Website: www.usukraineda.com

Principles - Igor Mosyak (imosyak@eurosoftusa.com)

Eric Candle (ecandle@ecdata.net)

USUDA's mission is to promote and support Ukraine's transition to an economy that provides for effective and widespread use of IT. Guided by the direct needs of its members, the alliance also leads and shapes the larger forum to advance global access to IT products and services both in the U.S. and Ukraine.

American Chamber of Commerce, IT Committee

Website: www.amcham.kiev.ua

Jorge Zukoski, Executive Director

Email: jzukoski@amcham.kiev.ua

Ukrainian Association of Software Developers

Website: www.uaswd.org.ua

Victor Spiridonov, Executive Director

Email: victor_spiridonov@uaswd.org.ua

UASWD is an international, nonprofit, nongovernmental organization formed to promote sustained and significant growth of the software industry in Ukraine.

U.S. Commercial Service Kyiv, Ukraine

Website: www.buyusa.gov/ukraine/en

Frank Carrico, Principal Commercial Officer

Email: kiev.office.box@mail.doc.gov

from the Kharkiv and Kyiv Polytechnical Universities. Moreover, thousands of scientists are engaged in commercialization of defense technologies through such institutions as the U.S. government-supported Science Technology Center of Ukraine (www.stcu.kiev.ua) and the Civilian Research and Defense Foundation (www.crdf.org). Opportunities exist here to tap these institutions as a source for research and development and to take advantage of risk-mitigating partner and grant programs.

Prospects for U.S. Companies

New legislative and institutional development have increased foreign investment prospects for U.S. companies interested in the ICT sector in Ukraine. The United States is already Ukraine's top foreign investor and a significant supplier of much of the country's IT equipment. Recently, the U.S. Export-Import Bank re-opened in Ukraine for export credit guarantees of up to 7 years in both the private and public sector. The Ukrainian parliament has introduced legislation that promotes foreign investment in the IT sector and aims to improve intellectual property rights (IPR). However, practical enforcement experiences so far have been dismal, and foreign investors should remain cautious in their IT ventures in Ukraine. It should be noted that Ukraine remains intent on joining the WTO and IPR enforcement will remain a key issue in those discussions.

One resource for U.S. companies looking at Ukraine's IT sector is the U.S.-Ukraine Digital Alliance, which kicked off its formation with an event in Washington, DC, that included over 100 attendees and a panel of both U.S. and Ukrainian IT companies discussing their projects in Ukraine. Other resources include the Ukrainian Association of Software Developers, the American Chamber of Commerce in Ukraine's IT Committee, and the U.S. Commercial Service in Kyiv, and BISNIS in Ukraine. All organizations are ready to support U.S. companies in finding partners, gaining market information, and organizing events to promote U.S.-Ukraine commercial relations.

*Jeffrey Kamins covers Ukraine for **BISNIS** in Washington, DC.*

For more info. on Ukraine, visit www.bisnis.doc.gov/ukraine.htm.

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REGIONAL INITIATIVE SUPPORTS BETTER BUSINESS IN THE RUSSIAN PROVINCES

by Alex Apanius

The governments of the United States and the Russian Federation established a special initiative in 1997 under the Russian-U.S. Joint Commission on Economic and Technological Cooperation to create an attractive business and investment climate in regions beyond Moscow and St. Petersburg. The initiative—known as the Regional Initiative (RI)—focuses U.S. technical assistance in the regions of the Russian Far East, Samara, and Tomsk. The Agency for International Development (USAID) and the U.S. Departments of State, Commerce, Energy, Agriculture, and Justice are active in these regions.

Technical assistance programs in Russian regions currently work to resolve many of the problems faced by the Russian small business sector, such as lack of financing, overregulation, corruption, and partial court rulings. The programs also work to improve small businesses and the institutions that serve their interests. These efforts also help to improve the business and investment climate for U.S. companies seeking to operate in these regions. They increase both U.S. knowledge of the regions and opportunities there, and Russian exposure to U.S. ideas and experts. Contacts made on both sides are useful resources for U.S. companies looking to enter or expand their activities in Russia's regions.

The RI Regions

In the Russian Far East, technical assistance in the area of business development has focused on policy advocacy, micro-and small business lending, lease financing, and training in Western management practices. The Russian Far East is a priority region for a number of reasons. Geographically, it is located closer to the U.S. West Coast than the Russian political center in Moscow and has developed ties with many U.S. businesses and communities. In addition, the Russian Far East is rich in natural resources and serves as a potential gateway for U.S. exports to and investment in Russia.

The RI office is located on Sakhalin Island, where foreign-funded offshore oil projects have played a major role in increasing economic activity. An American Business Center was established on Sakhalin to facilitate and support business related to the oil activity. Rapid development is changing the region and is creating new challenges such as meeting the demand for a tremendous increase in skilled labor and ensuring that the region shares the benefits of the oil boom. The RI and other assistance providers must address these types of issues.

As an RI site, the Samara region has also enjoyed a high concentration of U.S. technical assistance. Apart from Samara's strategic geographic position on the Volga River, it enjoys a leadership position in industry and business within Russia. Heavy industry and manufacturing are concentrated in the cities of Samara and Togliatti—automobile manufacturing being

the most prominent. The region has also benefitted from strong political leadership and support for foreign cooperation and investment. Regional Governor Titov has been a strong supporter of U.S. technical assistance, praising a number of projects, particularly in international accounting standards and banking sector reform.

In addition, the RI has presented the Samara region as an attractive region for investment, sparking the interest of the U.S. Export-Import Bank. As a result, the Ex-Im Bank has entered a deal to provide a large loan guarantee for exporting U.S. agricultural equipment to Samara. Samara is one of six Russian regions for which Ex-Im Bank accepts projects.

Tomsk is the RI's newest and most unique site in that it does not serve immediate U.S. commercial interests. However, its intellectual base and potential for high-tech enterprise are enormous. In addition to a full array of business development programs, the regional administration has shown particular interest in the development and promotion of technology commercialization. On November 28–30, 2001, an Interregional Exhibition of Innovative Technologies (INTECH) highlighted new technologies, particularly in the energy, chemical, and information sectors, as well as biotechnologies, medicine, and the environment. Currently, local officials, several universities and research institutes, and the business community are developing plans for establishing new centers to promote the commercialization of innovative technologies.

RI Websites

Samara
www.internetelite.ru/samarari

Tomsk
www.ri-tomsk.org

Russian Far East
www.ri.sakhalin.ru

ties and research institutes, and the business community are developing plans for establishing new centers to promote the commercialization of innovative technologies.

The RI brings U.S. experience and expertise to priority regions of Russia, and, more importantly, raises the international status and importance of those regions. Locally based RI coordinators are active in supporting technical assistance on the ground and often interact closely with local officials, the local business community, and multiplier organizations. They also work to promote U.S. business interests in their respective regions by serving as a point of contact, providing recommendations and consultation. Their experience and local knowledge make them excellent resources for U.S. companies new to the markets of the Russian Far East, Samara, and Tomsk.

Alex Apanius works in the Assistance Unit for the U.S. Department of State in Moscow.

RUSSIA'S BUDDING BIOTECHNOLOGY MARKET

by Elena Borodina

Russian President Putin's request of the Government to set more ambitious goals for economic growth and pay greater attention to the creation of a knowledge-based economy has made the development of innovative industries one of the prevailing topics in the Russian media and government policy circles. The growing frequency and quantity of Government decrees and initiatives in the biotechnology sector indicates that it is viewed as a high priority sector for Russia. However, this attention has not led to increased financing, which remains the main constraint for development of Russia's biotechnology sector.

Currently, over 65 percent of the market for biotechnology products in Russia is made up of imports. While the growth of the pharmaceutical and dietary supplements market in Russia is slowing, the demand for biotech products in agriculture and food processing is growing fast. The environmental protection sector receives the lowest level of financing, and it is mostly occupied by domestically made biotech products. Due to continuing growth of its consumer market and the historical strength of Russian science, Russia has strong potential both as a producer and a consumer of biotechnology products.

Market Assessment

The estimated capacity of the world biotechnology market has reached \$200 billion a year. Russia accounts for about 0.5 percent of the world biotechnology market. Expert estimates of the current Russian biotechnology market range from \$1 billion to \$1.4 billion. Foreign suppliers and manufacturers occupy some 65 to 70 percent of this market, while Russian company sales amount to \$300–360 million (about 30 percent). The optimistic forecast of the Russian agriculture biotech market potential is \$2.5–3 billion per annum.

The growing sectors for application of biotechnology products are dietary supplements, pharmaceuticals, agriculture, food processing, and environmental technology.

DIETARY SUPPLEMENTS (DS)

Estimates of the dietary supplements (nutritionals) market in Russia range from \$1.4 billion (Plekhanov Academy) to \$1.9 billion (expert appraisal in mass media). Russian products occupy 65–70 percent of the market, and foreign products have 30–35 percent by quantity, but the value of the foreign producers' market share is inversely proportional—about 60 percent. Currently, there are more than 2,000 manufacturers of dietary supplements (DS) in Russia. Expert forecasts say that the growth of the market will slow down significantly in the near future, and competition will increase.

According to research of the Plekhanov Academy of Economics, the ratio of female to male consumers of DS is 60:40 (formerly 75:25). The age of active consumers is 30 to 55; middle and lower income groups are the most active.

Distribution of DS products is handled by multi-level-marketing companies (about 60 percent of the market in value terms) and through traditional channels: manufacturer–wholesaler–retailer. The retailers for the traditional distribution system are drugstores, chains of health-related product outlets, single kiosks, and stalls. Consolidation of retailers in the western part of Russia is increasing—15 companies control about 80 percent of retail sales, and eight of them are chains.

The number of products is growing rapidly. Between 1997 (when certification and registration procedures for DS were introduced) and December 2001, the Russian Sanitary Inspection Agency received 3,973 applications for DS and granted 2,665 certificates.

The most popular DS products in Russia are those with pharmacological effects. Although in the early years of DS manufacturing most products were generic in their applications, currently producers are trying to produce DS for specific health problems. The products with growing popularity are: immune system boosters, anti-stress, cancer protection, sedatives, digestion and bowel improvement, and sport supplements.

PHARMACEUTICALS

According to Abercade Consulting (Moscow), in 2001 biotechnological products within the Russian pharmaceutical market accounted for some \$580 million. Russian companies had only a 25–30 percent market share. The products include vaccines, insulin, antibiotics, etc. According to *Vedomosti* newspaper, in 2001 the Russian insulin market (mostly state financed) was supplied by products from Novo Nordisk—58 percent (Denmark) and Eli Lilly—29 percent (USA). Russian manufacturer Ferein accounts for 3–5 percent of the insulin market, but it does not supply government orders.

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**The Pulp and Paper Industry
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AGRICULTURE

The world market of biotechnology for the food industry and agriculture in 2001 was estimated at \$45 billion. The estimated capacity of the Russian market for biotech agricultural products is currently about \$500 million a year.

The volume of consumption of biotech products for animal farming is several times higher than in the plant growing sector, although horticulture demonstrates a slow but continuous increase. According to Abercade Consulting, 95 percent of biotech preparations in animal farming is supplied by foreign manufacturers. A similar situation is observed in the plant growing sector—about 75 percent of the biotech products for this sector are imported. Large agricultural industrial complexes are the most frequent end users of imports. The remaining 25 percent of the market is supplied by Russian companies and consumed by smaller agricultural firms.

The devaluation of the ruble in 1998 stimulated investment in Russian agriculture. In 2000, agricultural production in Russia grew by 5 percent, and in 2001 by 6.8 percent. Growing competition in the Russian agricultural market and resumed growth of imports force Russian producers to seek efficiency through introduction of new technologies and materials. The demand for biotech products in farming and horticulture is expected to continue to grow.

FOOD PROCESSING

The annual demand of the Russian food processing industry for biotech products is estimated at \$100 million. The products include yeast, ferments for alcohol distilling, beer and wine manufacturing, bacterial products for milk processing, and GMO additives for meat processing. Annual sales of bacterial concentrates (including concentrates enriched with health enhancing bacteria) for the milk processing industry in Moscow amount to an estimated \$1.6 million. The growing investment in the food processing industry on a regional level leads to steady growth in demand for these products.

ENVIRONMENT

Environmental protection is one of the most poorly financed areas of the Russian economy. Although there is an enormous need for new, efficient environmental technologies in Russia, financial constraints limit opportunities for U.S. imports. Russian biotech products and processes currently occupy the biggest share in this market segment due to their low prices. The following sectors of biotech applications for the environment show growth potential: treatment of oil spills, ethanol and methane production from industrial and agricultural waste (including bio-reactors), bio-rehabilitation of soil and water, and biotechnology in rare metal extraction.

Players in Russia's Market

Russian biotechnology research centers and production facilities are concentrated in the western part of the country. Amongst the better known Russian biotech research centers

are the network of biological institutes in the Puschino center of the Russian Academy of Sciences (Moscow region), the Moscow Institute of Epidemiology and Microbiology, Vektor (State Scientific Center of Virology and Biotechnology in Koltsovo, Novosibirsk), and the Moscow State University of Applied Biotechnology.

The only large manufacturer of bioactive supplements for animal farming in Russia is Bogdanovichy Mixed Feed Factory (Sverdlovsk Oblast).

Pharmaceuticals-related biotech production was the first to attract investment in Russia. JSC BIOCAD (Moscow region) is currently completing construction of a pharmaceutical plant for manufacturing interferon and other genetic engineering products. The production is GMP certified. Also, RAO Biopreparat has announced an investment project for insulin production. The annual Russian government-financed order for insulin is worth \$90–100 million.

DS imports from the United States are represented by more than 50 manufacturers, including such companies as **Herbalife**, **Irwin Naturals**, **Enrich**, **Neways**, **Royal Bodycare**, **Sunrider Manufacturing**, and **Bactolac Pharmaceuticals**. Russian competition is represented by over 500 companies with registered products, and a large number of firms selling DS without the necessary registration. Competition in the DS sector includes products from more than 40 countries, including China (over 45 manufacturers), France (15), the Czech Republic (11), Israel (10), and Indonesia (13). There are also many unregistered manufacturers and products from various countries, most distributing products through multilevel marketing partnerships.

Russia currently imports U.S. biotech products manufactured by the following companies: **Alltech** (feed for poultry and meat farming), **Monsanto** (GMO soy products), **Cargill** (agriculture and food processing products), and **Archer Daniels Midland Company** (soy proteins, additives, and flavorings). In this sector, competition from other countries is represented by KMC (Netherlands - potato starch); Aventis Animal Nutrition (France - feed); Bayer AG and BASF AG (Germany); Babolna Takarmany (Hungary); Suomen Rehu and Rehuraio Oy (Finland); and Provimi Holding N.V., Hifeed BV, and Van Aarsen International BV (Netherlands). U.S. imports also include biotech equipment, various laboratory tests (e.g., **Applied Biosystems**) and reagents (**ICN Biomedicals**).

Elena Borodina is the BISNIS representative in Vladivostok, Russian Far East.

For a longer report on the Russian biotech sector, with an emphasis on specifics of this market in the Russian Far East, as well as sources of finance, legal regulations, and trade promotion opportunities, visit www.bisnis.doc.gov/bisnis/isa/020729biotech_rfe.htm.

Regional Spotlight: Krasnodar Krai, Russia

by Judith Robinson

Beautiful Krasnodar, home of the Kuban Cossacks, with its wide fertile northern plains, its subtropical seacoast, and the slopes of the northern Caucasus, is high in economic potential, economic growth, and business risk. About the size of Ireland, the region is home to some 5 million people, seven times Russia's average density at 67 people per square km, half urban and half rural. It remains part of the "breadbasket" of the nation and is a southern gateway to the world, based on its key ice-free ports on the Black Sea and Sea of Azov.

Krasnodar is the capital and largest city of Krasnodar Krai (region). A conservative regional government has been replaced by a government that is actively encouraging foreign investment through legislation and trade conferences and events. At the same time, the radical changeover from a planned to a free market economy has brought tremendous social, political, and cultural, as well as economic, re-orientation. Disruption in the northern Caucasus has caused social dislocations that have kept the unemployment rate high and per capita production about half the national average. Nevertheless, Krasnodar Region holds tenth place in Russia in terms of gross regional product among the 89 regions, and it is a net contributor to the federal budget.

Krasnodar bestrides Russia's "Black Earth" soil belt, boasting a favorable climate and over 100 different crops, as well as orchards, vineyards, tea plantations, citrus trees, rice, sunflowers, and a developed network of processing, storage, and trade facilities. This has generated demand for seeds and fertilizers; all types of food processing and packaging of grain, vegetable, fruit, dairy, meat, poultry, and fish products; and related equipment and machinery. Rich natural resources, reserves of oil and natural gas, deposits of 60 minerals including marble, limestone, and sandstone, plus 1,500 hectares of forests, form the base for industrial development. Oil extraction/transport, petrochemicals, tourism, woodworking/furniture, construction, and light manufacturing contribute to regional output.

As a frontier and crossroads, Krasnodar Krai ports such as Novorossiysk and Tuapse account for nearly 70 percent of Russia's trade turnover, serving the Transcaucasus and countries of the Caspian Sea, the Black Sea, and beyond. The newly built Caspian oil pipeline, which terminates in Novorossiysk, will bring more energy wealth to the region. In addition, work has started on the Blue Stream gas pipeline project from southern Russia to Turkey. The region is one of the most visited tourist areas of Russia, with services in sanatorium/health care and tourism amounting to some \$355 million in 2001. The city of Sochi and mountainous areas above the beaches are currently being developed by Greek, Turkish, and U.S. companies.

Krasnodar's regional trade turnover exceeds \$1.5 billion,

with imports amounting to less than two-thirds of exports. Of the region's 120 trade partners, the greatest volume of business is done with Italy, France, and Greece, and exports are heavily weighted in favor of fuel and power products, followed by raw and processed food stuffs. Foreign investment in Krasnodar Region ranks third after Moscow and St. Petersburg, with foreign investment at the millennium at some \$960 million. Beginning in 1999, the Krasnodar regional government passed laws supporting investment, with incentives in tax credits, and support of leasing, housing construction, and insurance. There are several hundred registered joint ventures with foreign capital, most with Turkey (146). The United States has about 70. Multinational companies in the region include **Cargill**, Nestle, **Chevron**, Petrak, **ConAgra**, **Monsanto**, Tetra-Pak, Danone, **Pepsi-Cola**, **Philip Morris**, **Troy**, Bouygues, **Radisson**, and the Caspian Pipeline Consortium companies. Not all foreign investments have been successful. The U.S. Embassy in Moscow has recently been encouraging local and regional officials to improve the transparency of the investment climate and ensure that foreign investors are treated fairly.

The region has recently attracted special attention from the U.S. Export-Import Bank, which signed a memorandum of understanding with Krasnodar Krai on July 16, 2002, to organize an agricultural equipment leasing company, capitalized at \$20–50 million, in the region. The region's economic potential will be highlighted in Sochi on September 26–29, at the first Kuban-2002 economic forum, organized by the Russian Ministry for Economic Development and Trade and the Krasnodar Krai Administration (visit www.forum-kuban.ru).

Judith Robinson covers southern Russia for BISNIS in Wash., DC.

For more information on southern Russia, visit BISNIS Online at www.bisnis.doc.gov/southern.htm.

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FERMENT IN THE RUSSIAN BREWING INDUSTRY

by Jeff Procak

The Russian brewing industry, perhaps more than other sectors of the economy, has benefited greatly from 10 years of economic transition. Emerging from an environment in which breweries hid behind generic labels and produced beers of ill repute, the Russian brewing industry has improved drastically not only in quality, but in assortment, brand, and packaging. The brewing industry is one of the leaders in terms of attracting foreign direct investment, with several major companies active in Russia—South African Brewers is in Kaluga, Sun Interbrew (Belgian-Indian joint venture) in the Moscow region and Omsk, Efes (Turkey) in the Moscow region, and Heineken in St. Petersburg. This influx of foreign investment has engendered serious competition from Russian brewers (St. Petersburg's Baltika dominates the market, while Kazan's Krasniy Vostok and Moscow's Ochakovo are major players as well).

The past 3 years have witnessed market consolidation and expansion by these major players—Heineken recently acquired Bochkaryov from Iceland's Bravo; Baltika has acquired breweries in Tula and Rostov-on-Don and broken ground on a new facility in Khabarovsk; and Krasniy Vostok is building a new brewery in Novosibirsk. Whether targeting the mass consumer market or beer aficionados, the Russian brewing industry presents opportunities for foreign investors, particularly in the upstream and downstream sectors of the industry.

Brewing in Siberia

Apart from the bottled beer market, the microbrewery/brewpub market is beginning to develop in Russia. The situation in Siberia provides an example of these developments in the Russian provinces. In Tomsk, Tomsk Beer has opened a bar and restaurant complex adjacent to its brewery, while the Omsk-based Sibirskaya Korona brewery (controlled by Sun Interbrew) has established its own bar/restaurant in Tomsk.

In Novosibirsk, the beer connoisseur will find summer-time pavilions sponsored by the national brands (Baltika, Tolstyak, Klinskoye, Sibirskaya Korona, Zolotaya Bochka, and Nevskoye). The local brewer, VINAP, is better known for its champagne-style sparkling wines, but it produces beer under one of the Soviet-era brands (Zhigulyovskoye). The Utyos Brewery, a small operation situated just outside the city of Tomsk, produces two styles of excellent "live beer"—a light Vienna-style brew and a dark porter-style potion. Utyos is in the process of improving its production facilities and developing an entertainment complex in the area surrounding the brewery.

Utyos imports malts from England and hops from Germany because Russian suppliers can guarantee neither quality nor output. Tomsk Beer also relies on Germany for its hops and malts. Recent reports indicate that as much as 70 percent of the 800,000 tons of malt consumed by Russian brewers annually is imported. The major brewers (Baltika, Ochakovo) have

commissioned the construction of their own malt facilities; Sun Interbrew has divested its Russian malt facilities to MaltEurop and Greencore, which over the next 6 years are expected to expand plant capacity by a factor of three (to achieve annual output levels of 250,000–280,000 tons). In terms of hops, the Chuvash Republic is generally recognized as the cradle of the domestic industry. It is possible that the recently enacted legislation regarding the lease and sale of agricultural land in Russia will create an attractive environment for the development of domestically grown and processed malts and hops.

Best Prospects

In addition to the upstream market, investment and equipment sales opportunities appear promising both in the core brewing activity and in the downstream market. With Baltika and Krasniy Vostok constructing new facilities, there may be an opportunity to provide brewing equipment. More difficult to assess, yet still providing a potential market, would be the sale of secondhand microbrewery equipment from defunct facilities in the United States for use by entrepreneurs looking to establish microbreweries/brewpubs in some of Russia's other major cities. Similarly, there may be potential for investments in or sales to Russian brewers seeking to develop their brand appeal through the establishment of a chain of associated pubs/restaurants similar to the Sibirskaya Korona property in Tomsk.

Of equal importance is the development of logistical practices to improve the handling and expand the market penetration of Russian beers. While the national players have seemingly overcome these obstacles, regional brewers such as Tomsk Beer could benefit from improvements so as to serve markets in Western Siberia generally. The only notable drawback regarding market expansion (and involvement in the Russian brewing industry generally) is that it is extremely competitive. Nevertheless, it should be noted that German and British suppliers and Belgian, Dutch, Indian, Turkish, and South African investors have established themselves as major and successful players in this sector of the Russian economy. The absence of U.S. brewing interests is a glaring omission, particularly in light of the success achieved by **Coca-Cola** and **Pepsi** in the Russian soft drink market.

Jeff Procak, a former World Bank country officer for Russia, is currently based in San Francisco. In June 2002, he worked, under the auspices of ACDI/VOCA (www.acdivoca.org), with a small consulting firm in Tomsk to improve its proposal writing skills and capabilities. Mr. Procak can be contacted by email at jeffprocak@bruinsfan.com.

*For Russian brewery websites, beer festivals and other resources related to the sector, visit **BISNIS Online** at www.bisnis.doc.gov/bisnis/isa/020816beer_ru.htm.*

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